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with a foreword by Sir Keith Joseph.

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# Foreword
by Sir Keith Joseph

In 1974, Mrs Thatcher and I founded the Centre for Policy Studies to compare our own experiences and those of our European neighbours – who have been doing rather better than we – and to survey the scope for replacing increasingly interventionist government by social market policies, and to seek to change the climate of opinion in order to gain acceptance for them.

In the course of this work, particularly in my talks with large university audiences, I have been struck by the fact that the new generation knows little of the market economy and its potential. It stands in contrast to the collectivist concepts that have been the pervading fashion in British politics; it rejects the drift towards state socialism and centralisation that has been gathering pace through crisis after crisis for twenty years. But bitter experience of our own trammelled economy's performance and the growth of social conflict pari passu with intervention seems – in my own experience at least – to have generated in many a readiness to consider the virtues of the market.

The term *market* needs some explanation and qualification. We favour social market policies, in the sense of responsible policies which work with and through the market to achieve wider social aims. The Centre has elaborated the concept of a social market economy at greater length. The restatement should be of particular interest now that the Conservative Party is reconsidering its strategies and social policies along market-oriented lines.

Experience has taught us that the only real alternative to a market economy is a command economy, in which narrow short-term expedients reflecting conflicting party-political considerations dominate government economic behaviour.

We are also learning – or re-learning – that a command economy means a command society; that the state, in order to secure its uncontested domination over economic life, must increasingly

dominate people's livelihoods, and limit their freedom of choice in education, health, housing, jobs, careers, savings, their access to the media of expression and later their access to information. In short, a command economy means increasing dependence for the citizen. *Hence our reiterated conviction that a market economy with freedom to own property and engage in production of goods and services is an essential condition for all other freedoms.*

Whatever views may be imputed to us we claim no perfection for the market mechanisms; no social order can be better than the imperfect humanity which constitutes it. But we do claim on grounds of logic and history that the market economy within a humane framework of laws and social services gives freest scope for material, social and cultural development and the quest for happiness.

I hope that this exposition will lead some readers to reconsider conventional wisdom and to approach our social market philosophy with fresh eyes.

Keith Joseph

# why Britain needs a social market economy

Since the war, rising prosperity and increased leisure have enabled the mass of the British people to enjoy their individual freedoms on a scale never previously realised. But it is a paradox that, just when personal liberty is beginning to characterise the life-style of a whole generation, that generation has produced so many articulate members who have failed to perceive that their life-style depends crucially on a socio-economic system which they claim to abhor. There is a need to demonstrate to these people that freedom is indivisible, and to explain to them the underlying contradiction between extreme egalitarianism and freedom; the role of prices, profits and competition in creating wealth; and the intimate link between personal liberty and the diffusion of economic power.

History has taught that, while it is not a sufficient condition, a system of economic freedom is a necessary condition for political freedom. Economic totalitarianism seems unable to coexist with political liberty. The greatest threat to individual liberty lies in the concentration of power. And, if economic power is once allied to

political power, concentration is almost inevitable. Conversely, if they are retained in different hands – if economic power is dispersed widely throughout society – political power can be limited too. Private ownership – ie economic independence – acts as a check on the accumulation of power by government and thus safeguards the existence of personal liberties. Furthermore, it is a happy accident that private enterprise nourishes a form of economic organisation – which is the market economy – which has proved itself the most powerful generator of material welfare that mankind has ever known. As Solzhenitsyn wrote in his 'Letter to the Soviet Leaders' (January 1974): '(Marx) was mistaken when he forecast that the proletariat would be endlessly oppressed and would never achieve anything in a bourgeois democracy; if only we could shower people with as much food, clothing and leisure as they have gained under capitalism'.

A market economy may be defined as an economic system in which the mechanism of variable prices functions freely to signal consumer preferences and, through its effect on profitability, to encourage the allocation of resources – manpower, capital and raw materials – so as to satisfy those preferences. The consumer exercises choice by voting with his purse. It is an impersonal system which permits decentralised initiative in the use of resources; this in turn promotes competition and efficiency while maximising the range of consumer choice. A market economy can be contrasted with a command economy – such as exists in the USSR and Eastern Europe – in which consumer preferences are registered primarily by the appearance of shortages and resources are allocated by administrative discretion, that is to say, by bureaucratic direction. It should be emphasised that, in a market economy, employees are free to develop and offer their skills to the company which will pay the most for them. The alternative to such a system is the collectivised one of communist countries where the direction of labour to specific functions by the bureaucracy has been the natural consequence of the direction of capital. Free trade unions can only operate in a free economy; in a command economy they inevitably become the tools of the state.

The expression 'social market economy' is a literal translation of the German term 'soziale Marktwirtschaft' which was coined by

Professor A. Müller-Armack and popularised in the 1950s by Ludwig Erhard as Economics Minister in the Adenauer governments. The notion it conveys is that of a socially responsible market economy, for a market economy is perfectly compatible with the promotion of a more compassionate society. Indeed, by encouraging the energies and initiative of the creative and sturdier members of our society, the resources available for helping the aged, the sick and the disabled are substantially enlarged.

The scope and quality of our social services depend crucially on the health and efficiency of industry. Industry alone creates the wealth which pays for social welfare. The more industry is left free – and indeed encouraged – to get on with its vital job of creating wealth, the greater will be the money that can be devoted to social purposes. Conversely, when industry is vilified and squeezed, the result is lower profits, lower wages, less employment and thus a reduced capacity to pay the taxes which alleviate distress and advance education. In short, a profitable, efficient and thriving industry is the precondition of a humane, compassionate and civilised society.

It is a grave indictment of our educational system and of all who are in a position to shape social attitudes that the rationale and distinctive features of the market economy are not better understood in our society. To many people it represents no more than a primitive form of economic organisation with a moral content directly descended from the dog-eats-dog condition ordained by the proverbial law of the jungle. Furthermore, because it is seen as a system which 'just growed' over the years, it is considered to lack an internal logic or coherence; founded, as it is deemed to be, upon no systematic philosophy, the allegation follows that it is haphazard, arbitrary, anarchic, and wasteful. Surely, the thought-process runs, enlightened twentieth-century man, armed with the tools of modern science, cannot fail to design a 'better' scheme of things?

The reality is quite different. All experience confirms that the market economy is the most efficient mechanism the world has known for performing the bewilderingly difficult task of

coordinating the efforts and desires of the millions of individuals and firms that constitute a complex industrialised economy. No human mind or bureaucracy can comprehend all the knowledge which guides the actions of society; hence the need for impersonal processes, not dependent on bureaucratic judgements, to coordinate individual efforts. The market economy incorporates those processes. And by dispersing economic power throughout society it establishes a countervailing force against the concentration of political power, thereby promoting democracy, personal liberty and wider choice of both goods and jobs – leaving the state to see fair play.

Support for the market system does not imply advocacy of laissez-faire in the sense of wishing to outlaw government from economic affairs. Historically the market economy is neither a right-wing nor a left-wing concept. And it can in principle embrace all of a multiplicity of forms of ownership – large private and public companies, state-owned corporations, one-man firms, partnerships, producer and consumer cooperatives, and so on. Its principal characteristic is the ubiquity of choice for consumer, employee and investor – which demands a multiplicity of production units competing vigorously for the consumer's approval, the employee's services, and the investor's savings. Experience has demonstrated conclusively that these conditions can be more assuredly satisfied the larger is the privately-owned and managed sector of industry and the greater are the number of competing firms within that sector. There is now abundant evidence that state enterprises in the UK have not served well either their customers, or their employees, or the taxpayer. For when the state owns, nobody owns; and when nobody owns, nobody cares.

The market system is not without its imperfections. But, such as they are, the imperfections by no means warrant a widespread aversion to markets per se. Neither do they establish a presumption in favour of political intervention, for the record of the political process in satisfying the citizen's desires can certainly not be said to compare favourably with that of the market process.

The market's shortcomings are well known: it does not in itself

ensure that the occasional divergence of private and social costs/benefits is reflected in prices; it often fails to provide for those who, through misfortune, cannot provide for themselves; it may bring about a distribution of income, wealth and economic power which many people find unacceptable. There is therefore a clear need to complement the market system with various 'social' policies – especially to help the old, the ill, the handicapped, the disabled and the unemployed, and to ease the transition in industries in which rapid structural changes are taking place. Poverty and deprivation must not be tolerated where, in the absence of government intervention, they would otherwise occur. However, because successive governments have neglected the teachings of market economics, attempts to help the less fortunate have usually been misconceived and cost-ineffective, and have often done more net harm than good. For market economics has something to tell us about the *form* government intervention should take so as to minimise the distortions that ensue. In other words, market mechanisms have a positive role to play in the more effective achievement of social goals.

There is thus a need for some government intervention in the economy – but in a form which limits the resulting distortions. More positively, it can be readily accepted that a significant degree of government involvement is necessary to create and regularly refurbish a framework of law in which private enterprise can be truly competitive and responsive to consumer demands. Government has a clear responsibility to curtail restrictive practices and the abuse of monopoly power whether perpetrated by companies, trade unions, or professional associations. Government must be there both as a forum for establishing the rules and to appoint an umpire to interpret and enforce them. But if the state takes part, how fairly will it judge itself?

It is a matter of grave concern that the market economy attracts so much hostile and misinformed criticism. Those politicians, academics and businessmen who recognise its virtues have singularly failed to break through the thicket of adverse propaganda that surrounds it. That this hostility should be especially prevalent among the young is confusing – particularly in view of their equal hostility to the oppressive bureaucracies of

Eastern Europe. A priori, one would expect far more sympathy for the decentralisation of power that a market economy encourages from people whose professed objective is to 'do their own thing'. However, the fact remains that the notion that market forces, competition, the price mechanism and the profit motive are agents of social advance is distinctly alien to large sections of our society. It is alien because these concepts are only very incompletely understood.

How many of those who react with horror to the concept of a free market understand that the only alternative known to man is the heavy hand of bureaucracy? If the large number of people who vociferously declare themselves to be against both markets and bureaucracy is any guide, the answer would seem to be very few. It seems to be the case that, partly because of inadequacies in our education system, the overwhelming majority of our people are at no time in their lives encouraged to face up to the fact that every society must have some mechanism for acquiring information about consumer preferences; for allocating productive resources in order to satisfy those preferences; for determining the most efficient methods of production to use; for introducing incentives to save, to invest, to innovate, to use scarce resources economically; for coordinating the decisions of millions of individual firms and households so that what is produced is what consumers want and in the right amounts.

Nothing in the social market philosophy precludes the provision of financial assistance to low-income families to purchase those goods and services which society considers they should enjoy and which the ruling market price would otherwise place beyond their means. The essential point is that the price mechanism, like the profit motive, is a signal. Changes in prices and quantities demanded transmit vital information to producers and consumers. In the absence of such information about consumer preferences and production costs, which only the market can provide via the price mechanism, investment would be misdirected, manpower would not be used in the most effective ways, and products would be turned out in the wrong amounts in the wrong places. The net result would be large-scale waste and consumer dissatisfaction. Ample evidence for this scenario is

afforded by the experience in the USSR and Eastern Europe.

The role and meaning of profits also are widely misunderstood in our society. Though the profit motive is a most efficient mechanism for allocating resources, it is thought by many to be socially harmful. Profits are rarely seen as the reward for efficiency, risk and effort, or as the incentive for investment and expansion. Rather they are considered as an indicator of exploitation, even when the employees of highly profitable firms are paid comparatively high wages. In fact, with very few exceptions, high profits are a sure sign that a firm is pleasing its customers. As a consequence, the firm is able to pay higher wages *and* reinvest heavily to create new jobs, as well as to pay higher dividends to its shareholders. The profit element in price is the mechanism that brings supply and demand into balance.

Competition is another facet of the market system that has always come in for a good deal of criticism. The criticism is customarily based on two grounds – moral and economic.

The moral argument may be formulated as follows: competition is by definition the opposite of cooperation; cooperation is 'good' and so it follows that competition is 'bad'. As Engels said: 'Communism will abolish competition and replace it with association'. Alternatively it may be put this way: because one man succeeds in competition with another, he must do so at the expense of the other. But competition is by no means always what modern sociology calls 'zero-sum', ie, one party's gain is the loss of another. In the economic sphere it is more generally the case that all parties can gain from competing ; your competition forces me to use my resources more efficiently, thus benefiting the consumer by increasing total welfare. Indeed the great bulk of relationships in contemporary society – but particularly commercial transactions – are of such a 'non-zero-sum' nature, though not always conspicuously so.

Competition between individuals or firms is not of course confined to business. It regulates the rewards in so many other walks of life – in politics, in the civil service, in the arts, in the entertainment world, in sport. Moreover, it is a common

observation that, when left to their own devices, many people *choose* to spend a great deal of their leisure-time in pursuing or watching competitive activities like football, racing, chess or bingo. And, curiously enough, the competitive spirit of the Olympic games seems to be most highly valued by those countries which claim to abjure the demon of competition in their economic systems.

A society which succeeded in exorcising competition would be extremely hard pressed to find an acceptable way of matching its labour force to the available jobs. The only alternative to making a judgement as to competence (which implies competition) would seem to be the allocation of manpower either by a totally arbitrary procedure or by some form of nepotism or political favouritism – and either method would probably prove far more objectionable to the people involved that straightforward competition on merit.

Very few businessmen would have any doubt that some degree of competition – even a small degree – creates a powerful incentive towards innovation, more efficient resource management, greater responsiveness to consumer demand, and cost reductions in general. The effectiveness of increased competitive pressures in stimulating the search for more efficient ways of doing things is a well-attested phenomenon. Competition is the enemy of complacency.

Thus the market economy – which may also be called 'competitive capitalism' – promotes and preserves the decentralisation of economic decision-making which ensures a flexible and responsive reaction by the controllers of resources to consumer needs, thereby forging a higher and faster growing standard of living for the community. But support for the market economy proceeds also from a belief that adult members of society should, over very wide areas of choice, be regarded as best qualified to judge what is in their own interests and act accordingly. It is part of a wider belief in the freedom of personal choice which implies the limitation of state power and the encouragement of individual initiative. The public good is most effectively attained by allowing individual members of society 'to do their own thing', so far as

that is possible without harming other people; and the sum total of public welfare is most rapidly increased by harnessing, within the law and subject to competition, the motive of self-betterment. If man's natural desire for security and the wellbeing of his family is given rein, economic growth will come about spontaneously.

It is not an egalitarian creed, for it recognises the fundamental conflict between equality and personal liberty. It understands that, beyond a certain degree, equality can only be enforced at the cost of sacrificing individual freedoms. A capitalist market economy and the personal liberties it safeguards are not compatible with an extreme egalitarian society – which, anyway, has proved unattainable even under left-wing dictatorships, whatever their propaganda may claim. It is certainly possible to modify by government action the distribution of income and wealth without destroying the market economy – but this process can be carried only so far. Despite the achievements of competitive capitalism in breaking down class barriers and official hierarchies, a viable market economy does entail some private individuals with wealth and incomes considerably higher than the average citizen enjoys.

In point of fact, the prevalence of private wealth serves to protect the personal liberties of every member of society. The more there are private alternatives to the state as a source of employment and of patronage of the arts and charity, the greater will be the scope in our society for creativity, initiative, innovation, risk-taking and choice. The state imposes uniformity and standardisation. To take one example, the existence of private publishers and private funds safeguards freedom of expression since it is the surest guarantee that a multiplicity of viewpoints will be offered to the general public – some to meet public demand, some for propaganda.

It is a widely-held belief of the political left that the development in Eastern Europe of massive bureaucracies and political totalitarianism is an accident of history unrelated to the form of economic system they have adopted. This belief is a dangerous myth. There is an intimate connection between economics and politics. Capitalism is the elemental economic component of a free society. History gives no justification for thinking that individual liberty is a political issue whereas material welfare is an economic

issue and that *any* permutation of economic and political systems is practicable. On the contrary, the evidence suggests that every step towards replacing the market by administrative discretion takes us further down the road to political totalitarianism. In the UK over the past few years more and more economic decisions have been taken outside the market. The result has been intense pressure group activity in the political arena, the growth of direct action by employees, and greater social unrest generally as even the meekest and most law-abiding of citizens have come to realise that economic rewards are increasingly disbursed through the political system and according to criteria which attach greater importance to the strength of a man's voice than to his ability and contribution. The more governments have intervened to remove economic decisions out of the market and into the political arena, the more they have set group against group, class against class, and sectional interests against the public interest. The politicisation of so wide an area of the country's economic activities has set up strains which are threatening its social cohesion. In short, what the country is now confronted with is not a crisis of the market economy but a crisis of government interference with the market economy.

In an advanced, prosperous, and educated society, the political party which stands for individual freedom and against bureaucratic direction should in principle be assured of majority support. In a community like ours, where more than half of all households own their own homes and many more aspire to do so, the party which encourages private thrift, initiative and self-reliance – and which is ready to defend the individual against encroachment by the bureaucracy – should have a built-in bias in its favour. Moreover, the greater is the level of private savings, the lower the level of taxation can be. There is every indication that the majority of the electorate sympathise with the concepts expounded in this paper. But in the past there has been a failure to explain these concepts adequately and to translate them into practical policies sufficiently effectively for people to perceive the connection between principles and policies.

Since the war both major political parties in Britain have pursued the cult of bigness – leading to concentrations of power. They

have positively encouraged the growth of remote and inefficient bureaucracies in both the public and the private sector. The blind 'merger mania' of recent years was a vogue which is increasingly discredited. But the harmful consequences of fostering such monopoly power are still with us – and nowhere more patently so than in the nationalised industries and local government activities. Meanwhile, the welfare of our small business sector – the seedbed of our corporate life – has been gravely neglected. Governments should proceed from the now well-justified presumption that big is often bad; and they should place squarely on those who assert the contrary the onus of demonstrating that technical factors demand it. This must entail a continuing review of legislation on monopolies and mergers. The aim should be to promote personal independence and development of responsibility by encouraging the growth of the maximum number of autonomous economic units, be they companies, large or small, partnerships or cooperatives.

This is the measure of the task facing the proponents of a social market economy: to develop and gain widespread acceptance for policies that derive from and are consistent with the principles expounded in this paper. These principles have to be related to the every-day lives of the British people so that the particular is seen to derive from the general. Policies must be evolved to give everyone a direct and perceived stake in capitalism; nothing can be more assured to undermine the attraction of collectivism. Above all a capitalist economy needs capitalists – both savers and entrepreneurs – and the more the better. There can be no greater guarantee of political freedom than the mass ownership of private capital. For private capital gives economic security and independence to the citizen – freedom from other people's power. It must be encouraged and harnessed as a vehicle for the attainment of the ultimate in participative societies.

Since the war politicians have been trying to do too much; they are taking decisions which should be taken by individuals as parents, consumers, managers and responsible citizens. Having set out to provide a safety net for the minority who cannot cope for themselves, the state has proceeded to put a cage round everybody. As a result state paternalism is stifling initiative and

pre-empting resources which could be used more efficiently by private individuals and organisations. This view is widely held and is expressed in a growing desire for a decentralisation of decision-making away from Whitehall. If power is to be so diffused, we must nourish a free enterprise society in which, over all but a limited area of their lives, adult individuals are left free to make their own decisions and enjoy the dignity and self-respect which come through so doing.

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